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SUBJECT: FIRST OIL BID ROUND: THE GREATEST SHOW ON EARTH.

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Classified By: Classified By: EMIN Marc Wall, reasons 1.4 (b,d)

¶1. (C) Summary: On June 29 and 30, Iraq's Ministry of Oil (MoO) will award contracts to international oil companies to work eight large oil and gas fields, marking the largest bid round ever conducted, covering approximately 40% of Iraq's total proven reserves. A week before the event, on June 23, Oil Minister Shahrastani will be "hosted" by the Council of Representatives (COR). The Minister is trying to tame critics who claim that he is both moving too slowly in developing Iraq's oil sector and moving too fast in bidding out Iraq's oil wealth to foreign companies. The MoO itself is balancing between technocrats who believe they can still revive Iraq's flagging oil production with minimal international assistance and those who see a need to bring in rapid foreign investment and expertise. Meanwhile, a parade of IOC representatives has come to Baghdad to express a laundry list of concerns about the model contract offered in the first bid round. We expect the ambitious bid round will move forward, but that final approval of contracts with the IOCs will take many months to complete. End summary.

The Main Event: Iraq's First Bid Round

¶2. (C) On June 29 and 30, Iraq will award bids on more barrels of oil in a single bid round than at any other time or place in history. The first bid round, announced by Minister Shahrastani at a conference in London on October 13, 2008, will award management of six producing oil fields and two gas field (reftel). The MoO pre-qualified 35 firms to bid for the eight fields, and is encouraging firms to form consortia. The MoO will host the two-day event to received bids and announce winners at the Al-Rasheed hotel, located in Baghdad's International Zone. Stressing the transparent nature of the bid round, MoO officials state that the event will be open to the public and televised. (Note: PM Maliki personally invited Ambassador Hill to the event; the Ambassador plans to attend the opening, which will include a speech by Maliki.) In order to increase transparency, each bid will consist of only two parameters: 1. Remuneration Fee Bid (The amount per barrel the IOC will earn for oil production increased above the baseline established by the MoO.) and 2. The Plateau Production Target (The production rate which the IOC says it will sustain for at least a seven year period.) The MoO officials will enter these two bid parameters into a formula and immediately get a winner on each field. The MoO also has a maximum remuneration fee (MRF) which the MoO has not published. In the case where all bids exceed the MRF, then the MoO will inform the highest scorer in the bid round and allow that IOC to adjust its bid to comply with the MRF. (Note: Several IOCs have expressed the obvious concern that all bids may end up above the MRF and this will simply be a ploy to lower the remuneration fees in the bids. End Note). Ministry officials will accept and award the bids in consecutive order so that an IOC can adjust its bids on particular fields in accordance to results on previous fields. An IOC can be primary operator on only one

field. (Comment: Reducing the bids down to two biddable parameters will assist in making the process more transparent, but it also reduces the bids down to strictly financial terms. These bids will not take into consideration the technical capabilities of the IOCs, local content, indigenous personnel development, or indigenous industry Qindigenous personnel development, or indigenous industry capabilities development. The model contracts mention all of these factors, but they will not be determined until negotiations after the bids are awarded. End Comment)

The Lion Tamer: Shahrستاني meets the COR

13. (C) On June 23, Shahrستاني will meet the COR to discuss his ongoing efforts to increase oil production and COR concerns about the first bid round. Members of the COR Oil and Gas Committee (OGC) have told EconOff that they plan to call Minister Shahrستاني to task on his failure to increase Iraqi oil production. The OGC Chair, Dr. Ali Balo (KDP), places all blame for lack of progress on everything concerning oil in Iraq squarely at the feet of Shahrستاني. Dr. Abdul-Hadi Al-Hassani, OGC Deputy Chair, also says that Shahrستاني has done too little to build the Iraqi oil sector and bring foreign investment into Iraq. On June 15, COR member Shatha al-Musawi, United Iraq Alliance Independent, warned about the dangers of "giving" 50% of Iraq's oil wealth over to foreign control for 20-25 years. She had called for a COR special session on June 16 to hear the views of 20 previous and current Directors-General (DG) and Oil Ministry experts on the first bid round. COR Speaker Al-Samarraie declined the request, noting that Minister Shahrستاني would be speaking to the COR on June 23, and said that the COR

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could hear from the DGs and oil experts when the minister comes to speak.

And On the High Wire: Dissension within the MoO

14. (C) Minister Shahrستاني continues to push the first bid round forward despite resistance within the ministry. On June 14, Fayadh Nima, DG of the South Oil Company (SOC), condemned the first bid round in a Reuters interview. Nima, who was only appointed to run SOC last month, said that the MoO had already spent \$8 billion on these fields, and Iraq would waste those investments if the MoO turned the fields over to foreign control. He said that the MoO had developed those fields on its own, kept them running during years of wars and sanctions, and could redevelop them without turning them over to foreign companies. Nima, previously the DG for the Planning Directorate, had expressed similar views to EconOff prior to obtaining his new position, but without as much vitriol and not in public. Several ministry officials have described a split within the MoO over how to handle revitalizing the developed fields. The new Deputy Minister for Upstream, Abdulkareem Luaibi Bahedh, espoused similar concerns about the bid round to EconOff. At least two DG level personnel have stated that Thamir Ghadban, the head of the Prime Minister's Advisors Committee, holds the view that Iraq can redevelop the fields itself. (Comment: Prior to Nima's statements, these opinions had always been expressed quietly within the MoO and without much force. End Comment) Laith Al-Shahir, Legal Directorate DG, said that Iraqis do not normally voice differing opinions from their bosses. (Note: EmbOffs have heard complaints from several MoO officials about the way Nima expressed his misgivings, but not about the misgivings he expressed. End Note) Laith noted that what Nima did went against that grain, but if Iraq were to become a democracy, Nima should be allowed to express his opinion. (Comment: During a June 18 meeting with Laith, he continuously received phone calls and text messages from Fayadh Nima. We do not know the nature of these calls, but they came on the same day as rumors came out about Fayadh Nima potentially being fired. End Comment) Piling onto the

complaints, on June 21, the Kurdistan Regional Government (KRG) stated that the first bid round contracts would not be legal because they would be signed without consulting the producing regions and provinces, as required by the constitution. (Comment: This is an interesting point of view, since the KRG has signed oil production and exploration contracts without consulting the central government, as required by the constitution. Additionally, the KRG has signed contracts in disputed territories without consulting the relevant provincial governments. End Comment)

The Parade of Elephants: IOCs come to Baghdad

15. (C) During the week of June 14 to 18, executives from Lukoil, Exxon, Chevron and BP visited Baghdad. Total and Shell came to meet GOI officials in early June. In addition to GOI meetings, executives from BP and Chevron met with EMIN during their visit. Both companies expressed concerns about the legal and commercial framework surrounding the bid rounds. A Chevron executive said that they would prefer the contract be approved by the COR. He noted that this would add more confidence in the legality of the contracts and give the terms of the contracts the force of law in Iraq. (Note: Since Iraq has not passed a package of legislation governing the hydrocarbons sector to supersede pre-2003 laws, the prior laws remain in effect. Those laws require parliamentary approval of all hydrocarbons production contracts. The MoO maintains that the contracts to be awarded in this upcoming bid round are not to produce oil, since the IOCs will only provide services for MoO operating companies and the MoO will pay them for those services. However, several individual MoO officials and many COR members believe that CoR approval is required based on existing laws. This position was also supported by experts from the Iraq Energy Institute, a body of oil experts self-formed in London, in a paper requested by the chair of the OGC, Dr. Balo. OGC member Jabir Khalifa Jabir, Fadhila party, has expressed this same view to the press and EconOff on several occasions and applied this theory to the Shell Heads of Agreement and the CNPC Ahdab field contracts. End Note.)

16. (C) Both companies also expressed concerns about the ability to conduct the work required under the contract. The current structure of the contract requires the IOC to come to an agreement with the regional operating company (ROC) before any work is conducted. The IOCs believe this could cause unreasonable delays and possibly cause them to default on the contract due to the rigid timeframes built into the contracts. The overall oil infrastructure in Iraq also concerns the companies. The companies will plan and execute

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the work in the field, with agreement from the ROC, but the MoO will remain in charge of the connective infrastructure to take the oil from the field to the export terminals. The IOCs expressed skepticism of the ability of Iraq to execute the export projects needed as oil production increases. They questioned whether the MoO had the qualified personnel needed to staff the joint ventures with the IOCs and run the projects needed to support the increased production in the fields. They suspected that in addition to working the fields, the MoO will require them to rebuild the oil infrastructure throughout Iraq. (Note: This has been addressed within the MoO's model contract. IOCs will recover costs of this sort as a supplemental fee from a portion of the value of the increased oil production. End Note) Chevron officials noted that they had delivered a letter signed by the CEOs of Chevron and Total with questions they felt needed to be answered for them to bid. (Note: In a subsequent meeting between DG Laith and EconOff, Laith said that he had reviewed the Total/Chevron letter and could not answer the IOCs' questions. He felt that the IOCs had valid questions, but that there was too much uncertainty surrounding the legal framework of the first bid round

contracts. End Note.) Nonetheless, both BP and Chevron said they planned to submit a bid which would conform to the parameters of the model contract. Specifically, they said, "We will swallow hard and hope things work out."

Comment

¶17. (C) The bid rounds continue to be the best bet in town to increase oil production. However flawed the system to develop the contract and implement the bid round, it is the best defined effort the MoO has mustered. The schism within the MoO seems to be mostly a matter of "pride." Most of the Ministry's leaders were present in the 1970's and helped Iraq achieve its zenith - an OPEC leader and production of 3.5 million barrels per day. Some of the technocrats of the MoO feel that they can relive past glory and do this alone, and as the date of the bid round awards come nearer and even as the actual contracts are negotiated the voices against the effort may become louder. They admit that Iraq needs technical assistance from the IOCs, but do not accept that any control of the fields should be given to IOCs. Many of these will be the same technocrats that will have to work with the IOCs in the joint venture companies on the fields and from whom the IOCs will have to gain agreement to complete any work. The IOCs have expressed this as a concern. The IOCs are not certain that the MoO center will be able to control the ROCs.

¶18. (C) Currently, the technocrats opposed to greater IOC participation appear to have found an ally in the nationalist tendencies of many politicians. The Embassy has seen communications from politicians outside the COR warning against the bid round effort. These included letters by Kifah Numan, ex-DG of SOC, requesting the MoO scrap the first bid round and saying that he would refuse to sign any joint venture contract with a foreign company. These letters were sent before Fayadh Nima replaced Numan as SOC DG. Should these two groups opposing the first bid round contracts find common cause, it could form a toxic brew.

¶19. (C) Even after the June 29 and 30 event, the MoO can expect months of negotiations before a final contract is ready for any of the fields. Both IOC executives and MoO officials have estimated a minimum of six months before they agree upon a final contract with the MoO. That will put the Qagree upon a final contract with the MoO. That will put the final contracts coming out in the middle of the Iraqi parliamentary elections. If the COR must approve the contracts, Iraq may have to wait a year or more before a final approved and signed contract is implemented.

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